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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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2009 JUN 18 P 3:03

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
STI PREPAID, LLC AND DIALAROUND
ENTERPRISES INC. FOR APPROVAL OF A
TRANSFER OF ASSETS AND CERTIFICATE
OF CONVENIENCE AND NECESSITY TO
PROVIDE INTRASTATE
TELECOMMUNICATIONS SERVICES AND
APPROVAL OF TERMINATION OF SERVICE
BY DIALAROUND ENTERPRISES INC.

DOCKET NO. T-20517A-07-0135

DOCKET NO. T-04045A-07-0135

**STAFF'S POST-HEARING
BRIEF****I. BACKGROUND**

On March 2, 2007, STi Prepaid, LLC ("STi") and Dialaround Enterprises, Inc. ("DEI") (together "Applicants") filed an application before the Arizona Corporation Commission ("ACC" or "Commission") requesting authority to transfer DEI's assets and Certificate of Convenience and Necessity ("CC&N") to provide resold interexchange services from DEI to STi and to cancel DEI's CC&N for those services.

On April 3, 2007, Staff issued a Letter of Sufficiency and on January 9, 2009, Staff filed with Commission Docket Control its Staff Report in this matter. The Staff Report recommends approval of STi's application, subject to an extensive list of conditions.

On May 4, 2009, STi filed its exceptions to the Staff Report. On that same day, a prehearing conference was held in which the Hearing Division advised the parties as to certain information the parties were to present at the hearing in this matter.

On May 18, 2009, hearing was conducted in this matter. At the close of hearing, the Hearing Division directed the parties to file closing briefs. The parties were directed to include in the briefs a discussion of three specific issues: 1) the necessity of the Commission to address STi Prepaid's general concerns within the context of Generic Rulemaking docket; 2) the applicability to the instant proceedings of the preemption provisions of 47 U.S.C. § 253; and 3) the appropriate treatment of a performance bond as applied under the circumstances of the instant case.

1 Staff hereby files its closing brief as directed.

2 **II. STAFF'S GENERAL RECOMMENDATIONS**

3 Staff believes that STi has the technical expertise to provide intrastate long distance service,¹
4 has the financial resources with which to remain a viable provider,² and is a fit and proper entity to
5 provide the requested services.³ Staff has therefore recommended that the Commission approve the
6 application.

7 However, during the course of investigating this application, Staff received information
8 regarding a series of legal actions in other jurisdictions. Of particular concern was an action taken by
9 the Florida Office of the Attorney General in which several purveyors of prepaid calling cards were
10 investigated for fraudulent business practices. Among those companies were STi Phonocard, Inc.,
11 which was a sub-entity of the generic STi brand name⁴ and an affiliate of Telco Group, Inc.⁵, which
12 was owned by Mr. Samer Tawfik.⁶ STi Prepaid later purchased the assets of Telco Group, Inc. and
13 Mr. Tawfik is a 25 percent owner of STi Prepaid⁷, although the company testified that he will have
14 no day-to-day responsibilities with STi.⁸

15 At the conclusion of the Florida action, STi Phonocard and Telco Group entered into an
16 agreement with the State of Florida, titled Assurance of Voluntary Compliance, admitted at hearing
17 as Exhibit A-30, which spelled out the many restrictions and outright prohibitions found during the
18 investigation to be necessary to protect consumers. Staff reviewed the document and found many of
19 the compliance items to be valuable to Arizona consumers as well.

20 Staff then obtained a copy of the prepared statement of the Federal Trade Commission
21 ("FTC") on Prepaid Calling Cards, which was admitted at hearing as Exhibit S-2. In short, the FTC
22 statement weighed in on the state of the prepaid calling card industry in general and made several
23 recommendations of its own.

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26 ¹ Transcript, p. 130: 24.

27 ² Tr., 131: 3-6.

28 ³ Tr., 131: 7-11.

⁴ Tr., 69: 10-14.

⁵ Tr., 69: 17-19.

⁶ Tr., 69: 24-70: 2.

⁷ Tr. 70: 9-11.

⁸ Tr., 70: 19-21.

1 Having reviewed all of this information, Staff concluded that while STi's application should
2 be approved, there was sufficient reason to believe that the kind of regulatory practices and
3 restrictions that STi had agreed to as a result of the Florida action are necessary to provide security to
4 Arizona consumers and ratepayers who choose to use STi's services.⁹ The absence of these
5 conditions would significantly reduce Staff's confidence in the proposed application, such that absent
6 these conditions, the application should be denied.

7 **III. ADDITIONAL ISSUES**

8 Although in substance STi does not appear to dispute Staff's recommendation for approval of
9 its application, STi does not believe the Commission has the authority to impose several of the
10 recommendations Staff has included for the protection of Arizona consumers.

11 STi's exceptions center on two central arguments:

12 1) First, STi argues that the Commission's approval of this application, subject to
13 Staff's recommended conditions, would amount to an "unlawful rulemaking"; and

14 2) If the Commission approved the application, subject to Staff's recommended
15 conditions, and if those conditions only apply to STi, then the Commission's action would
16 "have the effect of prohibiting the ability of [STi] to provide ... intrastate telecommunications
17 service", a violation of 47 U.S.C. § 253.

18 Staff disagrees.

19 **A. Rulemaking Implications.**

20 Essentially, STi argues if the Commission applies these conditions only to STi, the company
21 would be subject to a condition that limits its ability to compete within the telecommunications
22 market against other telecommunications service providers who are not subject to these same
23 restrictions. Therefore, STi argues, the Commission must apply the objectionable conditions to all
24 providers, or none at all. However, according to STi, even if the Commission were to begin applying
25 these recommendations to all Arizona telecommunications providers, the practice would amount to a
26 rulemaking on the issue, which STi argues would be improper due to a lack of notice to the public
27 and the affected utilities. Therefore, the Commission lacks the authority to impose these conditions
28 either to the industry as whole (absent a formal rule-making), or to STi in particular. Staff disagrees.

⁹ Tr., 134: 21- 135:3.

1 Staff does not dispute STi's general references to the Arizona Administrative Code, including
2 the specific references to Rulemaking. However, Staff believes the references are inaccurately
3 applied. It is also worth noting that the Commission already has in place rules governing intrastate
4 long distance telecommunications services. STi is merely suggesting that supplemental rules must be
5 adopted to cover this unique set of circumstances. Staff believes such an approach would be not only
6 inappropriate under the circumstances, but a massive drain on Commission resources with no
7 foreseeable positive result. Rulemaking on the subject is simply not justified.

8 In general, Staff supports the concept that ratemaking is better done by implementation of
9 rules and procedures applied on a generic basis. However, not all matters must or even can be
10 addressed in such a manner. This has been recognized by the Arizona Supreme Court in *Arizona*
11 *Corporation Commission v. Palm Springs Utility Company*, 24 Ariz. App. 124, 536 P.2d 245. The
12 Court clearly acknowledged that when appropriate, rules of general application are desirable. But the
13 Court also very specifically left to the Commission the discretion to act on a case-by-case basis when
14 the circumstances dictated such an approach. The instant matter presents just such a situation.

15 The instant matter presents a fairly unique factual background in that STi is requesting
16 permission to provide intrastate long distance service that will be paid for exclusively by the use of
17 prepaid calling cards. While STi has argued that prepaid calling cards fall outside the Commission's
18 jurisdiction, Staff disagrees. To the extent that these cards represent the *exclusive* means by which
19 Arizona consumers will access STi's proposed services, the Commission has full authority to act in
20 the interest of the consumers to ensure that the consumers receive the telecommunications services
21 for which they pay. Neither party disputes that the Commission is charged to act in the interest of the
22 public. Neither party disputes that the public has had occasion to take issue with the way in which
23 prepaid phone cards have been marketed and sold across the country. And neither party disputes that
24 the way STi's services in Arizona will be accessed will be through the issuance of prepaid calling
25 cards. Therefore, Staff believes the Commission has authority to protect the public in the instant
26 matter by ensuring that safeguards are in place which have been shown to be appropriate to
27 implement in other jurisdictions.

1 **B. Preemption Pursuant To 47 U.S.C. § 253.**

2 47 U.S.C. § 253 (a) provides, in relevant part, that in general:

3 “No State or local statute or regulation, or other State or local legal
4 requirement, may prohibit or have the effect of prohibiting the ability of
5 any entity to provide any interstate or intrastate telecommunications
6 service.”

7 STi has argued that if the Commission were to implement Staff recommendations the effect of
8 the order would be to prohibit STi from providing its proposed services on a competitive basis with
9 other similarly-situated utilities. Staff disagrees.

10 STi interprets the language of section (a) too strongly. Immediately following the general
11 restriction language, the statute then addresses State authority in particular in section (b), which
12 provides, in relevant part, that:

13 “Nothing in this section shall affect the ability of a State to impose, on a
14 competitively neutral basis ... requirements necessary to ... protect the
15 public safety and welfare ... and safeguard the rights of consumers.”

16 In Staff’s view, this additional language clearly allows the Commission to impose precisely
17 the types of restrictions Staff has recommended for the protection of Arizona consumers.

18 In 1999, in *Communications Telesystems International v. California Public Utility*
19 *Commission*, 196 F.3d 1011, the Ninth Circuit Court of Appeals had the occasion to consider this
20 exact situation. In that matter, the CPUC received more than 56,000 complaints from California
21 consumers that their long distance service had been switched to CTS without their permission, a
22 violation of the Telecommunications Act of 1996 (the “Act”) known as “slamming”. After more than
23 a year of investigation the CPUC found that CTS had in fact engaged in slamming and imposed
24 several sanctions against the company, among them a three-year prohibition against providing long
25 distance services within the State of California.

26 CTS filed suit in federal district court, “arguing that the suspension on the provision of
27 intrastate services is preempted by § 253 of the Act, and should therefore be enjoined.”¹⁰ The Court
28 disagreed, citing *Louisiana Public Service Commission v. FCC*, 476 U.S. 355, 368-69, an earlier
Supreme Court case which, although settling a dispute under the predecessor to the Act, nonetheless

¹⁰ *Communications Telesystems International v. California Public Utility Commission*, 196 F.3d 1011, at 1014.

1 spoke to the issue of State authority. "The United States Supreme Court and the Ninth Circuit have
2 held that federal preemption of state regulation in the area of telecommunications must be clear and
3 occurs only in limited circumstances." *Id.* "[S]tate action may be preempted only for conduct that is
4 "flagrantly and patently" violative of the constitution," i.e., preemption must be "readily apparent."
5 *Fresh International Corporation v. Agricultural Labor Board*, 805 F.2d 1353 (9th Cir. 1986).

6 In its discussion of *Louisiana Public Service*, the Ninth Circuit provided a rationale that
7 applies to the instant matter. "The Act was designed to prevent explicit prohibitions on entry by a
8 utility into telecommunications, and thereby to protect competition in the industry while allowing
9 states to regulate to protect consumers against unfair business practices such as slamming." 196 F.3d
10 1011, at 1017.

11 In the end, the Ninth Circuit held that "The CPUC has the power to implement regulations
12 that are 'necessary' to 'protect the public' against slamming, which reasonably may include fines or
13 suspensions needed to prevent such unlawful activity." *Id.* And finally, "More crucially, as the
14 CPUC points out, the suspension handed down against CTS need not be necessary to prevent CTS'
15 slamming; rather, it need only be necessary to serve the interests recognized in § 253(b) of protecting
16 the public welfare.

17 Applied to the instant circumstances, the outcome is clear. The Commission has the authority
18 to impose the conditions Staff has recommended. As the testimony showed, STi acquired the assets
19 of a predecessor which had been part of group of telecommunications service providers who were
20 investigated for fraudulent business practices. As a result, STi, having become the successor in
21 interest to the claims against Telco Group and STi Phonecard, agreed to implement a series of
22 business practices which it agreed would provide protection for consumers. And as the company
23 stated at hearing, it does not find the practices and restrictions outlined in Staff recommendations to
24 be objectionable in and of themselves.

25 Those same concerns that were addressed in the Florida action are present in Arizona, such
26 that Staff believes that the same conditions under which STi operates in Florida should be the same
27 conditions under which it operates in Arizona.

1 The Supreme Court has supported Staff's interpretation of the Commission's authority, and
2 the Commission should either approve STi's application, complete with Staff recommendations, or
3 the application should be denied.


4 **C. Performance Bond.**

5 In its Staff Report, Staff recommended that the Commission impose two performance bonds,
6 each in the amount of \$10,000.¹¹ Although Staff traditionally only requires a single bond, in the
7 instant case, given the calling card industry's record of consumer issues, Staff felt that an additional
8 bond would be needed to protect consumers. At hearing, however, Staff withdrew its
9 recommendation regarding the imposition of a second \$10,000 bond, finding a single bond to be
10 sufficient.¹² Staff continues to support the imposition of a single bond. The bond should be issued in
11 the amount of \$10,000 and should be increased by an additional \$5,000 whenever the company's
12 income from sales of prepaid cards reaches \$9,000. Thereafter, the company should post and
13 additional \$5,000 bond each time the income comes within \$1,000 of the total outstanding bond
14 amount.

15 **IV. CONCLUSION**

16 Staff believes that the Commission has the authority to impose any and all of the
17 recommendations Staff has provided in the Staff Report, and in the absence of those conditions, the
18 application should be denied. STi should post a single bond in the amount of \$10,000.

19 RESPECTFULLY SUBMITTED this 18TH day of June, 2009.

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28 ¹¹ Staff Report, p. 9

¹² Transcript, 133: 6-25.

1 Original and thirteen (13) copies
2 of the foregoing were filed this
3 18th day of June, 2009 with:

4 Docket Control
5 Arizona Corporation Commission
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8 Copy of the foregoing mailed this
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